United States Court of Appeals

for the Second Circuit

APPELLANT'S REPLY BRIEF

ORIGINAL

74-2280

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P/S

IN THE

United States Court of Appeals

FOR THE SECOND CIRCUIT

Docket No. 74-2280

COLONIAL REALTY CORPORATION,
Plaintiff-Appellant,

—against—

JOHN MacWILLIAMS, JR., JAMES E. BRENNAN and COLONIAL PENN GROUP, INC.,
Defendants-Appellees.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

REPLY BRIEF FOR PLAINTIFF-APPELLANT

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Dated: January 21, 1975

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In the
UNITED STATES COURT OF APPEALS
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COLONIAL REALTY CORPORATION,

Plaintiff-Appellant,

-against-

JOHN MacWILLIAMS, Jr. et al.,

Defendants-Appellees.

On Appeal from the United States District Court for the Southern District of New York

REPLY BRIEF FOR PLAINTIFF-APPELLANT.

I.

THE STELLA DECISION DOES NOT HAVE THE FORCE OF STARE DECISIS IN THIS COURT.

1. The main thrust of defendants' brief (pp. 6-7, 15) urges that the single District Court decision in Stella*

*Stella v. Graham-Paige Motors Corp., 132 F. Supp. 100 (S.D.N.Y. 1955, Dimock, J.), remanded, 232 F. 2d 299 (2d Cir.), cert. denied, 352 U.S. 831 (1956).

controls this Court as stare decisis unless it be shown to be "clearly in error". That approach would stand the relationship between higher and lower courts on its head. The Courts of Appeals are appointed to review and correct the legal errors of the district courts, whether they be clear or subtle, not to be bound by them. Otherwise a district court ruling on a doubtful question of law would, in the absence of "clear error", bind a Court of Appeals (and presumably even the Supreme Court) in later cases and would thus become the law of the land.

It is, of course, thoroughly settled that the legal rulings of a lower court do not have the force of stare decisis in a higher court. Sbicca-Del Mac v. Milius Shoe Co., 145 F. 2d 389, 395 (8th Cir. 1944):

> "While we have great respect for the decision of Judge Campbell [in the district court], that decision is of course not binding upon us as a case of stare decisis; ***"

Flores v. Mosler Safe Co., 7 N.Y. 2d 276, 196 N.Y.S. 2d 975, 978 (1959):

> "*** lower court decisions *** are not binding upon this court ***"

Re Klingaman, 36 Del. Ch. 200, 208, 128 A. 2d 311, 316, 60 A.L.R. 2d 1175, 1182 (Sup. Ct. 1957):

> "The Vice Chancellor naturally felt bound by this decision [of the Chancellor]; but it has never been approved by this Court, and we are at liberty to examine it. This is so, notwithstanding that it involves a rule of property."

Accord: United States v. Crosson, 462 F. 2d 96, 102 (9th Cir.), cert. denied, 409 U.S. 1064 (1972); Jackson v. Carroll, 86 Okla. 230, 242, 207 P. 735, 746 (1922).

Defendants quote (Br. 8) from Burnet v. Coronado Oil & Gas Co., 285 U.S. 393, 406 (1932), a statement of Justice Brandeis commending the wisdom of stare decisis. Defendants omit to mention that the quoted language comes from a dissenting opinion; that Justice Brandeis voted to overrule the precedent on wnich the majority relied; and, most important here, that he discussed the precedential effect of a Supreme Court ruling, not of a district court decision.

2. Furthermore, the relevant language in Stella was dictum. Our main brief (pp. 5-6) so showed, and defendants do not contend otherwise. It is elementary that dicta

do not operate as stare decisis. Green v. United States, 355 U.S. 184, 197 n. 16 (1957); Humphrey's Executor v. United States, 295 U.S. 602, 626-27 (1935).

3. Nor is it significant that Stella has "stood unchallenged for almost two decades" (Def. Br. 2, 15),* or that it has been cited uncritically by a number of legal writers. If the Stella dictum was wrong in 1955, it did not become sound law through the lapse of time or through the inevitable citations in text books and law reviews.

Defendants contend that Stella should be followed because investors have relied on it. The record at bar does not contain the slightest hint that the present defendants relied on Stella; and it would make no difference if they did. Defendants' claim that investors in general have been acting on the strength of Stella is equally unsupported. The complete lack of pertinent case law suggests that insiders,

*The reference to Stella in a footnote to Rheem Manufacturing Co. v. Rheem, 295 F. 2d 473, 475 n. 3 (9th Cir. 1961), was plain dictum. The court there dismissed a 16(b) claim not because the statutory six months holding period had run, but because the defendant had acquired the securities "in good faith in connection with a debt previously contracted."

far from trusting the Stella dictum, have avoided the issue of timing by prudently putting a full six months between their purchases and sales. A lawyer foolhardy enough to recommend to his client a two-day gamble, on no firmer ground than the single district court dictum in Stella, might well deserve to have his shingle lifted.* In any event, an insider's error as to the length of the statutory holding period affords him no defense. He is "deemed capable of structuring his dealings to avoid any possibility of taint and therefore must bear the risks of any inadvertent miscalculation"; Champion Home Builders Co. v. Jeffress, 490 F. 2d 611, 619 (6th Cir.), cert. denied, 416 U.S. 986 (1974), quoting from Bershad v. McDonough, 428 F. 2d 693, 696 (7th Cir. 1970), cert. denied, 400 U.S. 992 (1971); Whiting v. Dow Chemical Co., CCH Fed. Sec. L. Rep. ¶ 94,923, at p. 97,179 (S.D.N.Y. 12/24/74).

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*In Lewis v. Varnes, F. 2d , CCH Fed. Sec. L. Rep. ¶ 94,849 (2d Cir. 10/30/74), this Court noted (p. 96,854):

> "Because Varnes, while an active officer-director, had last exercised his stock options on December 22, 1970, counsel advised him that any impediment under § 16(b) to a sale by him of Lilly stock would expire six months thereafter, i.e., June 22, 1971."

Counsel for Mr. Varnes apparently did not see fit to rely on Stella.

We submit this Court is free to determine the proper computation of the 16(b) holding period as a new matter. The Stella dictum is entitled to no greater weight than the force of its reasoning justifies. It does not have the effect of stare decisis in this Court.

II.

DEFENDANTS' STOCK PURCHASES, EFFECTED SIX MONTHS MINUS A DAY AFTER THEIR SALES, WERE WITHIN THE STATUTORY PERIOD.

Defendants' arguments addressed to the interpretation of the statute are essentially a restatement of Judge Dimock's reasoning in Stella, which has been answered in our main brief.

1. Defendants would read the statutory reference to a purchase and sale (or sale and purchase) "within any period of less than six months" as requiring that the two transactions "must both occur 'within' the time period" (Br. 9). On that basis, defendants contend that the day of the original purchase must be included in the statutory period.

The statute does not, however, say that the two

transactions must "occur" within the period. That is defendants' addition. It is, in our view, more natural to read the statute as referring to a purchase and sale (or sale and purchase) "within any period of less than six months from each other".* That reading comports with the statutory language that precludes liability if the insider holds the security purchased "for a period exceeding six months." On such reading, the statutory period clearly begins only after the day of the original transaction. That day must, therefore, be excluded from the computation of the period. Such exclusion is, of course, the common and accepted method of computing a period of time.

Even if the statutory language were deemed ambiguous, the doubt would have to be resolved against defendants. As Judge (now Chief Justice) Burger held in Adler v. Klawans, 267 F. 2d 840, 846-47 (2d Cir. 1959), section 16(b) -

> "must be strictly construed in favor of the corporation and against any person who makes profit dealing in the corporation stock."

*This is how the Chairman and Special Counsel of the SEC read the provision. Cook and Feldman, Insider Trading under the Securities Exchange Act, 66 Harv. L. Rev. 385, 409 (1953).

2. Defendants contend (Br. 10-11) that authorities from other areas of law should not be considered in computing the 16(b) holding period.* On that premise, it is more than strange that defendants place such heavy reliance on the "indivisible day" rule which, in certain circumstances, disregards fractions of a day. Certainly that rule, going back to the days of Blackstone, did not originate in the context of § 16(b), but was developed by authorities from other legal fields. The scope and meaning of the rule must, therefore, be garnered from the decisions which developed it in those fields, unless the purpose of § 16(b) requires a different result. Defendants point to no such requirement, and we perceive none. The authorities discussed in our main brief (pp. 9-10, 13-16) are thus clearly in point.

3. According to defendants (Br. 10, 13-14), the statutory phrase "less than six months" must mean "six months

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*Defendants invoke Lewis v. Dwyer, 365 F. Supp. 607 (D. Mass. 1973). The case discusses the time at which the exercise of a stock option becomes a "purchase" within § 16(b). It has nothing to do with the computation of the 16(b) holding period.

minus a day", since it would otherwise, in effect, be equivalent to "six months". We find no inconsistency. Congress did not see fit to provide that the holding period shall be six months minus any particular length of time. Nor does the legislative history suggest anything of the sort. Defendants' assumption that Congress intended six months minus one day is thus completely arbitrary. As we have shown (main br. 16), the statutory phrase "more than 6 months" (as used in 26 USC § 1222) does not mean six months plus a day but six months plus some time, however short. By the same token, "less than six months" (as used in § 16(b)) means exactly what it says, namely, less than six months, no matter how much less. In other words, any sale or purchase before the end of the last day of the six months is within "less than six months".

4. It is for this Court to decide whether it, and the Supreme Court, used - as defendants put it (Br. 14) - "loose language" when they defined the statutory holding period as comprising six months. Since defendants themselves suggest that, but for their "indivisible day" theory, "six months" and "less than six months" are in effect the same, the Courts' references to "six months" were plainly right.

Most recently, this Court again referred, not less than three times, to "the statutory six-month period", to "a sale within six months", and to "purchases and sales by an insider within six months"; Perine v. William Norton & Co., F. 2d , CCH Fed. Sec. L. Rep. ¶ 94,922, at pp. 97,170, 97,171 (2d Cir. 12/20/74). See also Lewis v. Varnes, F. 2d , CCH Fed. Sec. L. Rep. ¶ 94,849, at pp. 96,854, 96,855 (2d Cir. 10/30/74).

Moreover, the references to "six months" in the Rules and Regulations of the SEC can hardly be shrugged off as inadvertent. As previously noted, Rule 16b-6(b)* in effect defines the short-swing period as "within six months before or after the date of sale". Rule 16a-1(e), 17 CFR 240.16a-1(e), deals with a director who buys securities while still in office but sells them after he ceases being a director; he must report the sale if it "shall occur within six months after" the purchase. The Commission thus considers the applicable period to be six full months, not one or two days less. It can hardly be suggested that, in framing these Rules, the Commission failed to focus on the precise boundaries of the statutory period. The great importance to which the SEC's interpretation of § 16(b) is entitled has recently been re-emphasized by this Court in Perine v. William Norton & Co., supra.

*17 CFR 240.16b-6(b). For the text of the Rule, see Pl. main br. 31-32.

CONCLUSION

Defendants urge that the question on this appeal presents "one of the narrowest and least significant issues that could possibly be raised" and that, in terms of policy or jurisprudence, its resolution one way or another "simply does not matter" (Br. 7, 15). We cannot share this light-hearted approach to the interpretation of the securities laws. To be sure, the fate of the Union will not turn on the length of the 16(b) holding period; but it may well depend on the sense of responsibility that bar and bench will bring to their task of faithfully giving effect to the law of the land.

The order below should be reversed and the case remanded.

Respectfully submitted,

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Dated: January 21, 1975.

Service of ~~three (3)~~ Two (2) copies of the within
Reply Brief is hereby admitted
this 21st day of Jan. 1975

Gold, Farrell & Marks
Attorney(s) for Colonial Penn
Group, Inc.

Service of ~~three (3)~~ Two (2) copies of the within
is hereby admitted

this day of

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Attorney(s) for

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